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Health Care Financing Administration
Department of Health, Education and Welfare
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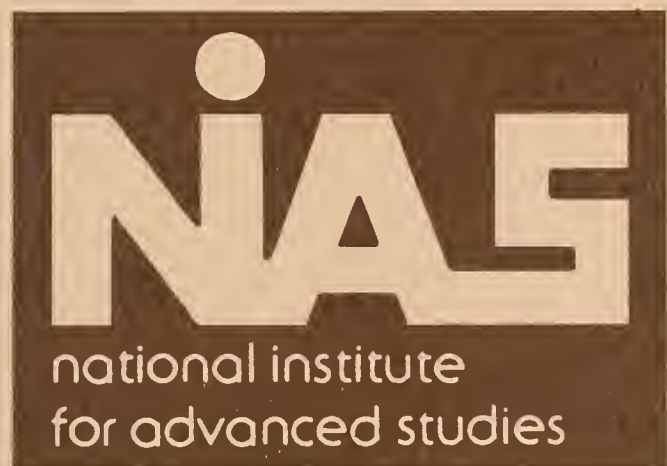
National Institute for Advanced Studies
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EXECUTIVE SUMMARY

March 20, 1978



EVALUATION OF MEDICAID ADMINISTRATIVE COSTS



REPORTS

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This report is made pursuant to contract SRS 500-76-0513

ACKNOWLEDGEMENTS

As one of the few minority owned firms with national scope that is actively involved in the evaluation of complex Federal health delivery and health financing programs, the National Institute for Advanced Studies is pleased to present this Executive Summary to the report *Evaluation of Medicaid Administrative Costs*. We believe that this report and companion volumes presenting case studies of six states represent a significant contribution to current national deliberations on Medicaid policy, the Medicare program, and the related issue of welfare reform.

This evaluation has benefited significantly from the cooperation and assistance of Medicaid Directors and their staffs in the six states which were studied. In addition, we are appreciative of the guidance and thoughtful review provided by the Project Officer for the Health Care Financing Administration, Mr. William Hickman.

Finally, we wish to extend our sincere appreciation to the many NIAS staff who devoted every effort to making this a quality product. Principal among the staff were James S. Fosdick, Project Director; Nancy Pindus, Associate Project Director; and Steven Poston. Also worthy of mention were subcontractors including Jack Martin & Co., and James Lash whose field work and contributions to the final report are likewise appreciated.

Michael L. Davis, Chairman
Board of Directors

This report is made pursuant to contract SRS 500-76-0513. The amount charged to the Department of Health, Education, and Welfare for work resulting in this report (inclusive of all previous reports submitted under this contract) is \$174,000. The names of the persons employed or retained by the contractor, with management or professional responsibility for such work or for the content of the report are listed above.

INTRODUCTION

This document summarizes the findings of an analysis of the costs and revenues of state administration of the Medicaid program (Title XIX of the Social Security Act). Federal funding of the Medicaid program consists of payments for basic health care services to eligible individuals (Medical Assistance Payments) and financial support to state agencies for administering the program. The purpose of this study is to provide the Health Care Financing Administration, which has federal responsibility for the Medicaid program, with a more detailed understanding of the effects of federal policies relating to federal support of Medicaid administrative costs.

The federally funded portion of Medical Assistance Payments (MAP) under the Medicaid program varies by state over a range from approximately 50 to 78 percent, depending, in part, upon each state's per capita income. The federally funded contributions to the administrative-cost portion of total MAP are 50, 75, 90, and 100 percent; varying according to the type of administrative activity that is being funded. Certain administrative activities receive higher Federal Financial Participation (FFP) percentages, in order to encourage states to allocate a greater amount of resources to these activities. Examples of administrative activities receiving higher FFP percentages, and their respective FFP rates, include the following:

- Use of qualified medical personnel, such as physicians, in Medicaid administrative and utilization review activities; reimbursed at the 75 percent level
- Development of an approved Medicaid Management Information System (MMIS); reimbursed at the 90 percent level

- Operation of an approved MMIS; reimbursed at the 75 percent level
- Licensing and certification of long-term care facilities; reimbursed at the 100 percent level.

An overall objective of this study has been to gain a more thorough understanding of the adequacies and deficiencies of the Federal Financial Participation policies which pertain to Medicaid administrative costs. In view of this overall objective, attempts were made during this study to seek out answers to the following basic questions:

- How do states allocate their Medicaid administrative resources according to various functional and cost categories?
- Why do states allocate administrative resources in the manner that they do?
- What are feasible indicators of administrative resource adequacy for federal monitoring purposes?

In order to answer these and subsidiary questions, a case study approach was pursued in seven states. The selected states were Illinois, Virginia, Washington, Arkansas, Maine, Utah, and Wisconsin. Wisconsin was eliminated during the course of the study, due to difficulties in obtaining reasonably adequate and accurate administrative cost data.

In the case studies for each of the selected states, both quantitative and qualitative information was obtained on-site from state Medicaid personnel. Quantitative cost and revenue data were obtained from an analysis of the OA-41 reports and supporting documentation. Based on interviews with personnel responsible for various segments of the Medicaid organization,

the costs and revenues were allocated to various functional areas, such as general administration, claims processing, and utilization review.

The collection of cost and revenue data on Medicaid administrative programs responds to the question of how states allocate their Medicaid administrative resources. In order to determine answers to the other questions posed for the project, such as why the allocations are made, it was important to obtain qualitative

information to complement the cost and revenue data.

Information obtained from interviews with Medicaid program directors concerned decision-making processes relevant to the allocation and utilization of resources. This approach provided a basis for assessing reasons or motivations for how the states allocate administrative resources. It also provided insight into what incentives the FFP percentages might have had on state spending patterns.

SUMMARY OF FINDINGS

Tables 1 and 2 demonstrate the allocation of Medicaid administrative costs among nine functional areas. For the six states in total, four of the nine areas (general administration, recipient services, provider services, and claims processing), receive approximately 87 percent of total costs.

Surveillance and utilization review is the next largest area with a weighted average of 9.3 percent and an unweighted average of 9.4 percent. The remaining functional

areas of cost settlement, fraud control, and third-party liability had a combined weighted average of only 3.7 percent.

Table 3 shows the number of full-time equivalent (FTE) staff according to the nine functional areas. Of the six states in the study, Illinois had the largest program (more than \$831 million in MAP) and more than half of the FTEs in the six states in total were in this state. During the year reviewed, Illinois did not use a fiscal agent

TABLE 1

Medicaid Administrative Cost by Functional Area and by State (in dollars)

STATE	FUNCTIONAL AREA									TOTAL
	General Administration	Training	Recipient Services	Provider Services	Claims Processing	Surveillance and Utilization Review	Third-Party Liability	Fraud Control	Cost Settlement	
ILLINOIS	(\$) 5,312,219	(\$) 164,525	(\$) 19,067,242	(\$) 4,694,386	(\$) 3,925,872	(\$) 4,038,197	(\$) —	(\$) 669,163	(\$) 934,656	(\$) 38,806,260
VIRGINIA	1,045,921	10,910	5,724,066	680,215	2,180,182	582,660	24,096	60,309	196,052	10,432,411
WASHINGTON	877,204	19,863	5,101,797	2,370,364	2,815,853	968,154	98,040	2,545	346,658	12,600,478
ARKANSAS	340,574	—	2,419,699	777,782	1,537,555	372,038	50,067	—	60,488	5,558,203
MAINE	516,377	24,286	125,158	695,979	818,685	258,718	11,623	53,866	89,433	2,594,125
UTAH	185,550	2,923	1,126,793	943,664	1,000,249	668,493	31,412	81,963	126,586	4,167,633
TOTAL	8,277,845	222,507	33,564,755	10,162,390	12,278,396	6,888,260	215,738	867,846	1,753,873	74,159,110

TABLE 2

**Medicaid Administrative Cost by
Functional Area and by State
(in percentages)**

STATE	FUNCTIONAL AREA									TOTAL
	General Admini- stration	Training	Recipient Services	Provider Services	Claims Processing	Surveillance and Utilization Review	Third-Party Liability	Fraud Control	Cost Settlement	
ILLINOIS	13.7%	0.4%	49.1%	12.1%	10.1%	10.5%	—	1.7%	2.4%	100.0%
VIRGINIA	10.0	0.1	54.9	6.5	20.2	5.6	0.2	0.6	1.9	100.0%
WASHINGTON	7.0	0.2	40.5	18.8	22.3	7.7	0.8	0.0	2.7	100.0%
ARKANSAS	6.1	—	43.6	14.0	27.6	6.7	0.9	—	1.1	100.0%
MAINE	19.9	0.9	4.8 ¹	26.8	31.6	10.0	0.4	2.1	3.5	100.0%
UTAH	4.5	0.1	27.0	22.6	24.0	16.0 ²	0.8	2.0	3.0	100.0%
WEIGHTED AVERAGE	11.2	0.3	45.3	13.7	16.5	9.3	0.3	1.1	2.3	100.0%
UNWEIGHTED AVERAGE	10.2%	0.3%	36.7%	16.8%	22.6%	9.4%	0.5%	1.1%	2.4%	100.0%

¹Does not include eligibility determination costs of those recipients who are categorically eligible.

²Includes cost of PACE project (ambulatory care review) and PSRO Review System.

TABLE 3

**Personnel Allocation by
Functional Area and by State
(Number of FTEs)**

STATE	FUNCTIONAL AREA									TOTAL
	General Admini- stration	Training	Recipient Services	Provider Services	Claims Processing	Surveillance and Utilization Review	Third-Party Liability	Fraud Control	Cost Settlement	
ILLINOIS	257.0	7.8	1,110.9	180.7	247.5	71.1	—	34.7	9.1	1,918.8
VIRGINIA	16.8	0.6	370.9	37.4	23.9	62.2	1.8	3.3	9.9	526.8
WASHINGTON	23.9	0.7	332.4	125.5	108.2	35.7	6.6	0.1	15.3	648.4
ARKANSAS	12.2	—	236.2	54.8	11.4	15.6	4.2	—	3.5	337.9
MAINE	16.4	1.3	9.8	41.5	30.5	14.5	0.4	2.2	7.1	123.7
UTAH	4.1	0.1	47.8	40.3	28.9	5.7	1.5	2.3	0.1	130.8
TOTAL FTEs	330.4	10.5	2,108.0	480.2	450.4	204.8	14.5	42.6	45.0	3,686.4

and did not have a Medicaid Management Information System (MMIS).

Table 4 shows the federal contribution as a percentage of total administrative expenditures for each of the nine functional areas. The greater this percentage, the more the state is utilizing the special FFPs of 75, 90, and 100 percent. For example, of the total administrative costs expended for provider services, the Federal Government contributed a weighted average of 63.4 percent—indicating the

involvement of skilled medical personnel (75 percent FFP) and the skilled nursing home certifications (100 percent FFP) in this function. At the other end of the range, recipient services, third-party liability, and cost settlement received close to the minimum 50 percent of federal support in each of the six states. The highest proportion of federal support for administrative costs was found in Utah, where 64.9 percent of administrative costs was reimbursed by the Federal Government; the lowest proportion was found in Virginia, with 52.0 percent.

Table 4

Federal Expenditures Per Functional Area as a Percentage of Total Administrative Expenditures (in percentages)

STATE	FUNCTIONAL AREA									TOTAL
	General Adminis- tration	Training	Recipient Services	Provider Services	Cleims Processing	Surveillance and Utilization Review	Third-Party Liability	Fraud Control	Cost Settlement	
ILLINOIS	57.8%	73.9%	50.0%	69.3%	51.0%	50.4%	—	52.5%	50.0%	53.7%
VIRGINIA	51.3	62.1	50.3	66.6	51.8	53.5	51.2	46.6	52.2	52.0%
WASHINGTON	63.3	50.0	50.1	47.7	53.9	73.0	50.0	50.0	53.0	53.3%
ARKANSAS	69.1	—	50.0	68.7	70.6	70.6	50.0	—	55.2	60.9%
MAINE	54.1	72.1	51.6	74.6	51.1	66.5	61.9	52.7	50.0	59.8%
UTAH	76.9	72.8	57.7	64.4	72.5	65.8	56.8	65.0	50.3	64.9%
WEIGHTED AVERAGE	58.2	70.9	50.3	63.4	55.7	57.1	51.6	53.2	51.0	54.8%
UNWEIGHTED AVERAGE	62.1%	66.2%	51.6%	65.2%	58.5%	63.3%	54.0%	53.4%	51.9%	57.4%

Exhibit 1 summarizes the sources of revenue which fund Medicaid administrative costs. Sources of revenue are federal Title XIX, other federal, state, and other. Except for Washington and Utah, no federal revenues were identified beyond Title XIX and state funds. Other Federal revenue sources included the Food Stamp Program, Title IV-A, Title XX and Department of Commerce.

EXHIBIT 1

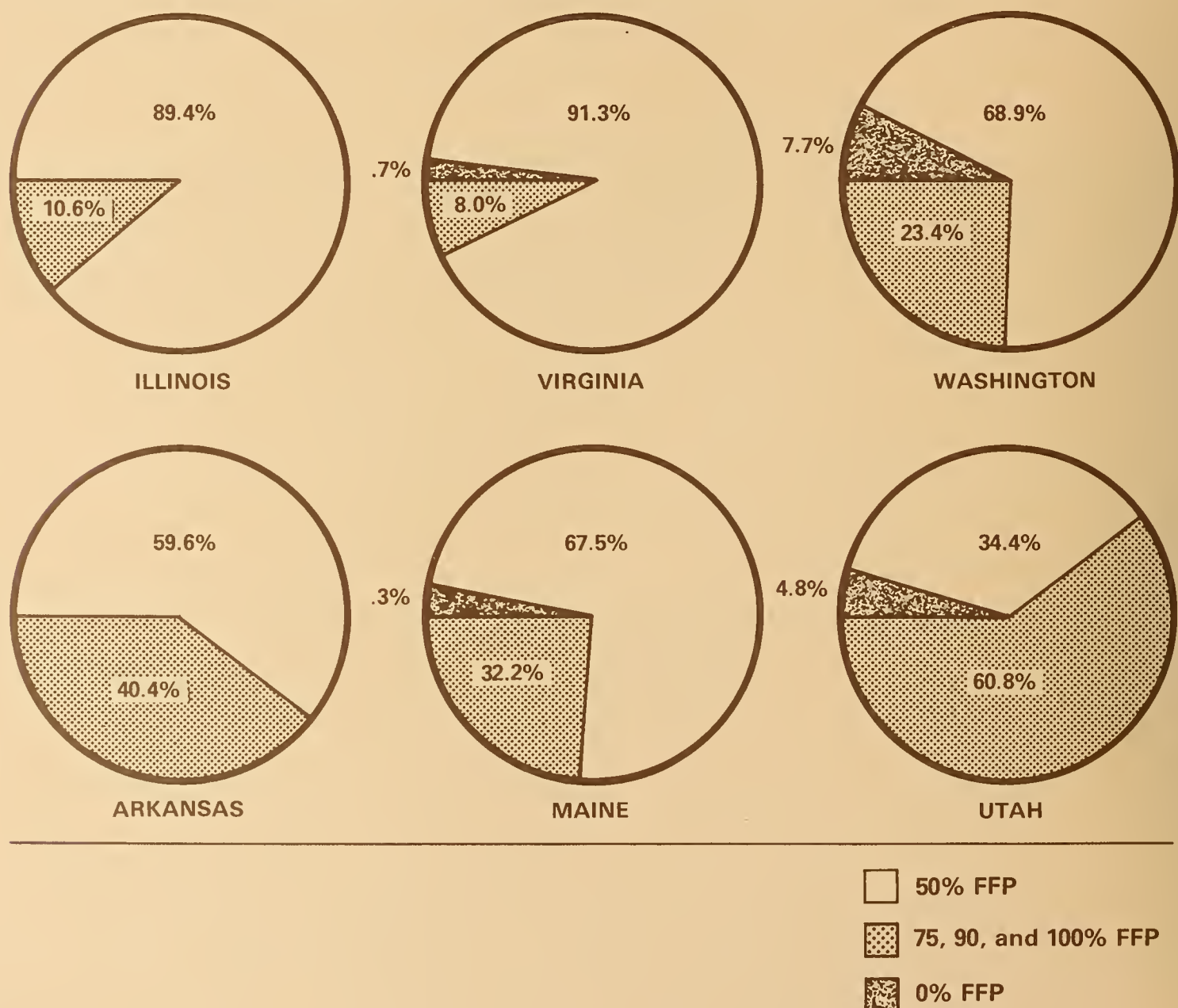
Sources of Revenue for Medicaid Administrative Costs



Exhibit 2 displays a summary of Medicaid administrative expenditures by FFP rate. The proportion of total revenues at higher FFP rates is a reflection of a state's allocation of resources to functions which are reimbursed at a higher rate. For example, only 8.0 percent of Virginia's Medicaid administrative costs were reimbursed at an FFP above the minimum 50 percent, while 60.8 percent of Utah's costs were reimbursed at FFP rates above 50 percent.

EXHIBIT 2

Total Medicaid Administrative Costs by FFP Rate



CONCLUSIONS

Allocation of Resources to Administration by Functional Area

- *Recipient services* (primarily eligibility determination) is the major component of administrative costs in most states. Four of the six states allocate between 42 and 55 percent of administrative costs to this functional area
- The sum of claims processing, surveillance and utilization review, third party liability, and fraud control costs range from 32 and 44 percent of administrative costs. *Claims processing* accounted for 20 to 32 percent, except in the case of Illinois whose lower costs indicate economies of scale due to the large number of claims processed
- Very little is spent by any of the states on *fraud control*
- Less than one percent of administrative costs are allocated to third-party liability in each of the six states
- Less than one-half of one percent of administrative costs are allocated to *training* in most of the states.

Allocation of Resources to Administration by Type of Cost

- Most administrative costs are spent for *personnel* (salaries and fringe benefits). The personnel allocation ranged from 49 percent to 67 percent, with an average of 62 percent
- *Electronic data processing* (EDP) receives an allocation of 27 percent to 31 percent for the three states which had an MMIS during the entire year analyzed
- As of 1976, there was great variation among the states in the allocation of

resources to *EPSDT administration*. Three states allocated between 20 and 40 percent of provider services costs to this provider type, while the remaining three states each allocated less than 1.5 percent of provider services costs to EPSDT

- The majority of costs for administration of provider services is spent on services to *long-term care facilities*, especially certification, inspection, and medical reviews and independent practitioner reviews (MR/IPR)
- Administrative costs as a function of MAP ranged from 3.5 percent to 8.2 percent, with an unweighted average of 5.5 percent
- The *federal share* of total administrative costs ranged from 52 percent to 65 percent, with an unweighted average of 57 percent. This range reflected not only the variations in types of activities funded under Medicaid administration, but also differing state experiences with, and perceptions of, HEW auditors' willingness to allow higher matching rates.

Impact of Special Matching Incentives

The higher FFP may not directly induce a Medicaid director to allocate resources to a particular area. However, once he decides that a function needs attention, the higher match usually helps him obtain the resources needed.

Impact of Related Programs

There is virtually no impact of related federal programs' administrative matching rates on the allocation of state employees to the Medicaid program. Five of six states

had no impact, while the sixth state had minimal impact, which was notable during a budget reduction effort.

Other Revenue Sources

There is minimal allocation of non-Medicaid revenues to the Medicaid program. Three states had relatively small amounts of non-Medicaid revenues, ranging from 0.3 percent to 8 percent of total revenues.

Administrative Complexities of Varying Matches

- Current Medicaid regulations regarding administrative costs are not interpreted uniformly by the state administrations nor by federal auditors. Some states are more aggressive than others in interpreting the regulations, in tracking costs associated with different FFPs, and in negotiating their interpreta-

tions with federal auditors. In most states that we visited, total federal revenues for administrative costs could have been increased by claiming costs which were claimed by other states.

- Tracking administrative costs by FFP is a difficult and time-consuming task. Again, some states are more aggressive than others. The states view this process as being non-productive (other than the obvious benefit of increasing their federal revenues).
- According to one state official, it is not possible to obtain 75 percent federal financial participation for the EPSDT outreach program when the 25 percent balance is paid by the counties.
- Finally, there is no place on the OA-41 report to list medical assistance payments for family planning, which are reimbursable at 90 percent FFP.

RECOMMENDATIONS

Federal Financial Participation

During the discussions with the Medicaid directors, three alternative methods of providing federal funding to the states were discussed:

- Variable matching rates, based on personnel and/or service area characteristics—the current approach, where specific segments of a program are defined, and a matching rate provided.
- Constant matching rate—this approach was the original approach used in the Medicaid program and is currently used in other DHEW programs. The same matching rate is used for all administrative costs.
- Variable matching rates, based on administrative performance criteria—

this approach would provide higher rates for achieving a given level of administrative performance.

After consideration of these alternatives, we recommend:

that the Federal Government adopt a constant matching rate (higher than 50 percent) for administrative costs.

Federal Monitoring of Medicaid Administrative Costs

The Federal Government currently measures Medicaid administrative costs as a percentage of total Medicaid Medical Assistance Payments (MAP); this is the only measure of administrative performance available. For many states, this percentage lies in the range from three to six percent.

There are many factors which, in the opinion of NIAS, should eliminate this statistic as a measure of administrative impact and effectiveness. As long as the Medicaid program is implemented differently by each state, there will be many factors which cause differences among state programs, and, thus, severely limit the comparability of using a simple total percentage or total dollars.

In order to understand the extent to which each of the administrative functions is performed for the Medicaid program of a given state, more detailed information must be obtained. Two alternatives can be considered:

- Develop a new, more detailed reporting system from the states to the Federal Government
- Perform periodic ad hoc studies, such as the present study of Medicaid administrative costs.

In order to improve the monitoring of Medicaid administrative costs at the federal level, we recommend:

that the Federal Government use a team of analysts to analyze periodically the Medicaid administrative costs in the states.

The current study could serve as the prototype for this review process. However, because of the wide range of program differences encountered in the states visited during this study, we strongly caution against the use of data obtained from the current study as being representative of all 53 Medicaid jurisdictions. Accordingly, we further recommend:

that the administrative costs of additional Medicaid jurisdictions be analyzed in order to develop a more representative data base.

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